NO. 648

In the Supreme Court of the United States

OCTOBER TERM, 1942

ANCEL EARP,
Petitioner,

VERSUS

H. C. JONES, Collector of Internal Revenue for the District of Oklahoma.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

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January, 1943.

UTTERBACK TYPESETTING CO., OKLAHOMA CITY, OKLA.

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Ancel Earp prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Tenth Circuit entered in the above cause on October 30, 1942, affirming a judgment of the United States District Court for the Western District of Oklahoma (Rehearing denied December 10, 1942).

OPINIONS BELOW

The District Court filed no opinion. The opinion of the Circuit Court of Appeals is not yet reported (R. 148).

JURISDICTION

The judgment of the Circuit Court of Appeals sought to be reviewed was entered October 30, 1942 (R. 152), and a rehearing denied December 10, 1942 (R. 166). The juris-

diction of this Court is invoked under Section 240-A of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether a concededly (R. 149) valid ordinary partnership established and existing under the laws of the State of Oklahoma between husband and wife can be ignored and the entire net income therefrom be taxed to the husband in complete disregard of the partnership provisions of the Revenue Act of 1936, C. 690, 49 Stat. 1648, and the Revenue Act of 1938, C. 289, 52 Stat. 447. Sections 181, 187 of both Acts are the same. Section 182 is slightly different.

2. Whether in the absence of any federal law defining the elements necessary to constitute an ordinary partnership the local law in regard thereto is controlling and is incorporated in the federal taxing acts, particularly Sections 181, 182 and 187, Revenue Acts of 1936 and 1938.

3. Whether for income tax purposes petitioners "economic status" (R. 149) remained unchanged after making a valid gift to his wife of property having a value of $36,640.00 which she thereafter contributed to the partnership or whether it can be said "for all practical purposes by such a gift petitioner surrendered nothing" (R. 151).

4. Whether petitioner can be taxed on income produced from property owned by his wife and contributed by her to a partnership composed of his wife and himself.

STATUTES INVOLVED

Sections 181, 182, 187 of Revenue Act of 1936, Chapter 690, 49 Stat. 1648, and

Revenue Act of 1938, Chapter 289, 52 Stat. 447.

STATEMENT

This is an action to recover alleged overpayment of federal income taxes for the years 1937 and 1938 by petitioner, a member of a partnership composed of himself and wife, engaged in the general insurance business, other than life. On December 1, 1937, petitioner conveyed to his wife a one-half interest in all of the assets of his business (R. 22, 12). On the same day a written partnership agreement was executed (R. 23, 12). Th property conveyed for gift tax purposes was found to have a value of $36,640.00 (R. 22). Partnership books were at once opened and partnership income tax returns were filed (R. 24). *The Circuit Court of Appeals concedes the partnership to be legal under Oklahoma law* (R. 149). The Commissioner of Internal Revenue disregarded the partnership and assessed deficiencies against petitioner for the two years in question, based upon the assumption that all income derived from the partnership was the income of petitioner (R. 20, 21). The taxes claimed were paid and on November 18, 1940, claims for refunds were filed and after disallowance (R. 21) this action was filed. The District Court rendered judgment in favor of the Collector (80, 81). The Circuit Court of Appeals affirmed that judgment (R. 152).

The Circuit Court of Appeals purporting to rely upon opinions of this Court felt justified after concluding that

the partnership was valid under state law in then disregarding it entirely and embarking upon an inquiry as to whether petitioner's "economic status" had undergone a change after the transfer of property to his wife, which she thereafter contributed to the partnership. It concluded it had not and that "for all practical purposes he (petitioner) surrendered nothing." Its justification for such inquiry and conclusion was as follows:

> "The Supreme Court has quite clearly laid down the principles which must guide us in the determination of this question."

A petition for rehearing (R. 157) was filed for the purpose of directing the Circuit Court's attention particularly to the two cases of *Helvering* v. *Stuart*, decided by this Court on November 16, 1942, as being in conflict with the opinion herein, which failed to give any recognition to the incorporation of the local law dealing with partnerships in the federal tax acts. The opinion in *Helvering* v. *Stuart* was further cited in the petition for rehearing for the purpose of showing that the few cases referred to in the Circuit Court's opinion had no application to a situation similar to that presented herein where there had been a valid *permanent* transfer of property and not a mere assignment of income.

SPECIFICATIONS OF ERROR

The Circuit Court of Appeals erred in holding that although the petitioner was a member of a concededly legal partnership under Oklahoma law, all of the income from such partnership was nevertheless to be considered as his

income for federal income tax purposes, in disregard of plain, specific and applicable statutes dealing with partnerships and the taxation of members thereof. (Sections 181, 182, 187, Revenue Acts of 1936 & 1938).

REASONS FOR GRANTING WRIT

1. The Circuit Court of Appeals, in holding that the income of a concededly valid partnership under Oklahoma law should all be taxed to one of the members thereof, ignored plain and specific statutes dealing with the taxation of members of partnerships. Sections 181, 182 and 187, Revenue Acts of 1936 and 1938. If the judgment rendered below is to stand, no member of a valid partnership under state law would ever know, even approximately, the extent of his tax liability at the time he filed his return or how his return should be filed. He would have no guide if the applicable Acts of Congress are to be ignored, for determining whether the Commissioner of Internal Revenue might or might not see fit to disregard a valid partnership.

2. The decision of the court below is in conflict with this Court decision in *Burnett* v. *Leininger*, 285 U. S. 136. In that case, where a member of a partnership transferred a one-half interest in his partnership interest to his wife, this Court, after citing the partnership taxing statute, directed its inquiry to the question as to whether a partnership between husband and wife existed as a result of the transaction. It was found that since the other member of the husband's partnership had not consented to the admission of the wife as a member, such lack of consent was fatal to the creation of a valid partnership. The case arose in

Ohio and on page 140 of the opinion it will be observed Ohio cases are cited as sustaining the Court's conclusions. There is no intimation in the opinion that any inquiry could or should be made, other than to determine whether or not under state law a valid partnership existed, and the existence of such a partnership in the case now before the Court is conceded. Had this Court not been of the opinion that in view of the partnership provisions of the taxing statute, the only question for consideration was as to whether a valid partnership existed under the state law, it could have very easily disposed of the case by simply saying, as did the Court below herein, that even if a valid partnership under state law did exist, the husband would still be taxable, as he and his wife should be considered as one "economic unit." This court in the *Burnett* v. *Leininger* case treated the question of the validity of the claimed partnership as decisive. The Court below considered that question unimportant.

3. The opinion of the lower court is in conflict with the decision of this Court in the two cases of *Helvering* v. *Stuart*, opinion filed November 16, 1942, in that it failed to recognize the incorporation by Congress of local law in the partnership taxing statutes. The right of petitioner and his wife to form a valid partnership depends upon the interpretation placed upon their arrangement by state law. The lower court concedes the arrangement herein created a valid partnership under state law. The state law created the right to transact business in partnership form, and when rights obtained under local law are once established "these rights are subject to the federal definition of taxa-

bility." *Helvering* v. *Stuart, supra.* Sections 181, 182 and 183, Revenue Act 1936, is a clear and specific designation as to how the right to engage in business in the form of a partnership created under state law shall be taxed. The Commissioner, in the Stuart cases, relied upon such cases as *Helvering* v. *Clifford,* 309 U. S. 331; *Harrison* v. *Schaffner,* 312 U. S. 579, etc. It was upon such cases that the opinion of the lower court herein is largely based. Their inapplicability is clearly pointed out by this Court in the Stuart cases.

4. The decision herein is in principle in conflict with the decision of this Court in the case of *United States* v. *Cambridge Loan & Building Co.,* 278 U. S. 55. That case involved the exemption of a building and loan association under the income tax laws. The taxing statute did not define building and loan associations just as the taxing statute herein fails to define a partnership. It was contended by the government that although the taxpayer was a building and loan association under the laws of the state of Ohio, it was in reality a bank, and was therefore not entitled to the exemption. This Court in deciding adversely to the Commissioner, said:

> "The State of Ohio has recognized and still recognizes the respondent as belonging to the class which its name indicates. Very possibly the company has strained its privileges to near the limit, but we are not prepared to condemn the nomenclature adopted by the State."

The decision complained of is in conflict with numerous decisions of the lower federal courts and of the Board

of Tax Appeals recognizing family partnerships all of which were cited in briefs filed in the Circuit Court. *Commissioner of Internal Revenue* v. *Olds,* 60 Fed. (2d) 252 (Sixth Circuit), *Humphreys* v. *Commissioner of Internal Revenue,* 88 Fed. (2d) 430 (Second Circuit), *Rose* v. *Commissioner,* 65 Fed. (2d) 616.

Champlin v. *Commissioner of Internal Revenue,* 71 Fed. (2d), 23, 10th Circuit. (This case arose in Oklahoma and involved an Oklahoma partnership. The court therein recognized the Oklahoma law as controlling. Oklahoma Statutes and cases are cited on page 27). *Kell* v. *Commissioner,* 88 Fed. (2d) 455; *Walter W. Moyer,* 35 B. T. A. 1155 (Okla.); *Jasper Sipes,* 31 B. T. A. 709; *B. M. Phelps,* 13 B. T. A. 1248; *Oakley* v. *Commissioner,* 24 B. T. A. 1082; *Harrington* v. *Commissioner,* 21 B. T. A. 260; *Hazelwood* v. *Commissioner,* 29 B. T. A. 595; *Newell* v. *Commissioner,* 17 B. T. A. 93; *Bennett* v. *Commissioner,* B. T. A., Docket No. 101715; (opinion filed September 2 1941); *Lynch* v. *Commissioner,* B. T. A., Docket No. 102149; *Ledbetter* v. *Commissioner* B. T. A., Docket No. 10482 (opinion filed January 19, 1942).

The facts in the Ledbetter case are almost identical with the facts herein. The taxpayer therein, Ledbetter, is engaged in the same line of business as is your petitioner and they are competitors. The judgment of the District Court herein is referred to by the Board of Tax Appeals in the next to the last paragraph of the Ledbetter opinion. The instant case is distinguished therein on three grounds, based upon the original findings by the District Court

herein to the effect that (1) petitioner's wife "never executed any documents evidencing a transfer of her undivided one-half interest of the taxpayer's insurance business to the new partnership." (2) That she contributed no personal service to the partnership, nor did she participate in its management. (3) That she contributed no capital to the partnership. After the Ledbetter opinion was filed on January 19, 1942, the District Court herein, however, entered amended findings of fact, which were not filed until March 18, 1942, and were in lieu of the earlier findings to which the Board refers. Under the first findings made herein by the District Court there clearly would have been no partnership under the state law, and had those findings been adhered to, this case would have been distinguishable from the Ledbetter case since under the original findings there would have been no partnership under the local law. Those grounds of distinction, however, no longer exist, and the Circuit Court concedes a valid partnership herein under state law.

5. We feel that the questions involved in this case are of public importance since under the opinion herein family partnerships are not recognized as partnerships within the purview of the partnership provisions of the Revenue Acts. No warrant can be found in any case justifying this form of judicial legislation indulged in by the lower court, and we respectfully suggest the lower court erred in endeavoring to modify the plain terms of the taxing statute by construction. *Crooks* v. *Harrelson*, 282 U. S. 55, 61. While we cannot furnish to the court a list

showing the number of cases now pending in various courts involving family partnerships, we feel justified in stating that they are numerous, as we have had requests from attorneys in various parts of the United States, having similar cases, requesting copies of our briefs.

CONCLUSION

It is respectfully submitted that for the reason stated, this petition for a writ of certiorari to the United States Circuit Court of Appeals for the Tenth Circuit should be granted.

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January, 1943.